

Part IV - Items of General Interest

Treatment of an Individual Nonmaterially Participating Partner's Distributive Share of Investment Interest Expense from a Trader Partnership

Announcement 2008-65

In Revenue Ruling 2008-12, 2008-10 IRB 520, the IRS clarified that a nonmaterially participating partner's distributive share of the interest expense of a partnership engaged in the trade or business of trading in securities is subject to the investment interest limitation in § 163(d)(1), provided that the partner is an individual. This conclusion is based on the definition of the term "property held for investment" in § 163(d)(5)(A)(ii). Pursuant to that definition, a taxpayer's interest in a trade or business activity that is not a passive activity is classified as property held for investment for § 163(d) purposes if the taxpayer does not materially participate in such activity. The scope of § 163(d)(5)(A)(ii) is narrow because trade or business activities in which the taxpayer does not materially participate are generally treated as passive activities under the general definition of "passive activity" in § 469(c)(1). However, certain specified trade or business activities are treated as per se nonpassive regardless of the taxpayer's degree of participation in the activity. For example, § 469(c)(3) provides that the term "passive activity" does not include certain working interests in oil and gas properties. In Revenue Ruling 2008-12, the partnership's activity involved the trading of

personal property (as defined in § 1092(d)) for its own account. Under § 1.469-1T(e)(6), such activity is treated as per se nonpassive. Thus, even though the partnership's trading activity rose to the level of a trade or business, its interest expense attributable to such activity and allocable to individual partners who did not materially participate in the activity was subject to the § 163(d) limitation, which is applied at the partner level.

Since publication of Revenue Ruling 2008-12, a number of taxpayers have inquired as to whether the interest deduction allowable to the nonmaterially participating limited partner after the application of the § 163(d) limitation would properly be reported on Schedule A, "Itemized Deductions" of Form 1040, "U.S. Individual Tax Return," or whether instead the allowable deduction would properly be taken into account in computing the ordinary business income or loss from the trade or business activities of the partnership on Schedule E, "Supplemental Income and Loss." Revenue Ruling 2008-38, published concurrently with this Announcement, provides that, in the case of an individual taxpayer, interest paid or accrued on indebtedness allocable to property held for investment described in § 163(d)(5)(A)(ii) is a trade or business deduction described in § 62(a)(1) that is deductible (after the application of the § 163(d)(1) limitation) in determining the taxpayer's adjusted gross income. Accordingly, the limited partner described in Revenue Ruling 2008-12 would properly include the allowable amount of his distributive share of the trading partnership's interest expense in computing the limited partner's ordinary business income or loss on Schedule E. Consistent with the reporting requirements of Notice 88-37, 1988-1 C.B. 522, the interest deduction of the limited partner that is properly reportable on Schedule E should

be identified on a separate line in Part II, Line 28, column (a), as “investment interest,” followed by the name of the trading partnership that paid or incurred the interest expense, and the amount of such interest expense should be entered in column (h).

DRAFTING INFORMATION

The principal author of this announcement is Faith P. Colson of the Office of Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this announcement contact Faith P. Colson at (202) 622-3060 (not a toll-free call).